

# THE ACCOUNTABILITY OF ISLAMIC MICROFINANCE INSTITUTION: AN EVIDENCE FROM INDONESIA

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## ABSTRACT

*The article aims to provide current condition's information on the accountability of Baitul Maal wat Tamwil (BMT) in Indonesia. Lack of supervisory board and low demand for audited financial statements provide little incentive for BMT managers to make their financial statement audited by independent auditor. Statistical estimation technique about one sample proportion, give an estimation with 95% confidence level that only 7-20% of BMT is audited by independent auditor. Most of the reason for BMT not being audited are because they feel they do not need an audit and the price for audit is relatively expensive.*

**Keywords:** *microfinance, Islamic microfinance, accountability, independent auditor*

## ABSTRAK

*Artikel bertujuan memberikan informasi kondisi terkini tentang akuntabilitas BMT di Indonesia. Kekurangan dewan pengawas dan permintaan yang rendah terhadap pernyataan finansial yang teraudit memberikan sumbangan yang sangat sedikit bagi manajer BMT untuk menjadikan pernyataan finansial mereka teraudit oleh auditor independen. Teknik estimasi statistik sekitar 1 proporsi sampel memberikan estimasi 95% confidence level dan hanya 7-20% dari BMT yang diaudit oleh auditor independen. Kebanyakan alasan BMT tidak diaudit adalah karena merasa tidak membutuhkan audit dan harga untuk sebuah audit cukup mahal.*

**Kata kunci:** *microfinance, Islamic microfinance, akuntabilitas, auditor independen*

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## INTRODUCTION

Indonesia has been developing their microfinance since 1970s. It is imperative that Indonesia have strong microfinance system as SME is the backbone of the economy. It is estimated that 89% Indonesia people are employed in small enterprises (including household and cottage enterprises) and accounting for 41% of Indonesian gross domestic product (Rice, 2000).

Indonesia is fortunate that Microfinance has received a full support from the government and state regulators. Bank Rakyat Indonesia (BRI) with its 4049 profit centre units in 2003, mostly at rural areas, becomes pioneer in sustainable microbanking system (Robinson, 2004). Besides BRI which a major player in microbanking industry, independent rural banks (BPR), and village credit banks (BKD) and other semi-formal and non-formal microfinance institutions (MFI). Many rural banks and semi-formal MFIs run their operation following the Islamic Banking Rule or well-known by Islamic Banking or Shariah Banking.

Saving and loan cooperatives also play an important role as microfinance institution. As per December 2003, there are 36.376 saving and loan cooperatives (KSP) and saving and loan units (USP) in Indonesia registered in Ministry of Cooperatives and SME (Depkop, 2004). Their total asset is more than IDR 6 trillion and serves more than 11 million people members and depositors.

BMT or Baitul Mal wat Tamwil is another Islamic microfinance institution. They are not banks, although most of them operate exactly like banks. Some BMT are registered with The Ministry of Cooperation and Small Enterprise as *shariah* saving and loan cooperatives. Some BMT also becomes part of Islamic cooperatives or as the business unit of Islamic charity organization. Most operate informally with minimum regulations and supervisions.

The development of Islamic Saving and Loan Cooperatives or BMT in Indonesia has been exceptional. The number of BMT has risen from 300 at the end of 1995, to 1501 at the end of 1997, and 2470 BMT in 1998 (Timberg,1999). As December 2005, there are 3.037 BMT registered in PINBUK (Pusat Inkubasi Usaha Kecil). That number includes BMT who has legal body as cooperatives, or “pre-cooperatives” who operate with PINBUK “Operation Eligibility Statement.” The definite number of BMT is almost impossible to find as many of BMT are not registered in PINBUK or affiliated to other NGO. All BMT is estimated have consolidated asset of more than Rp. 1 trillion, employed more than 30,000 workers with more than 40% of them are women. BMT serves 2 millions depositors and distribute micro credit to more than 1.5 millions micro entrepreneurs (Aziz, 2000).

However, the rapid development of BMT, is not followed by the development of reporting regulations and accounting standards. The precise definite legal status of BMT is somehow in doubt. Due their informal nature, many BMT do not have any legal form. Some small BMT are “pre-cooperatives”, run by operation eligibility statement from PINBUK, some has notarial deed as their legal form, some have legal form as cooperation or a non profit foundation.

This paper examines the accountability of BMT in Indonesia, specifically, to gain knowledge on the BMT’s efforts to make themselves accountable to their members or other financial statement users. This paper also describes the current condition of BMT on how many BMT are audited by independent auditor and how many of them are not and audited by internal auditor instead. Their reason of not being audited by independent auditor will also be explored in this paper.

This research aim to answer some of the following questions: From the sample BMT investigated, how do they make themselves accountable to their members; From the sample BMT in this study, how many of them are audited by an independent financial auditor; For those who are not audited by independent auditor, what would their main reason to avoid independent audit.

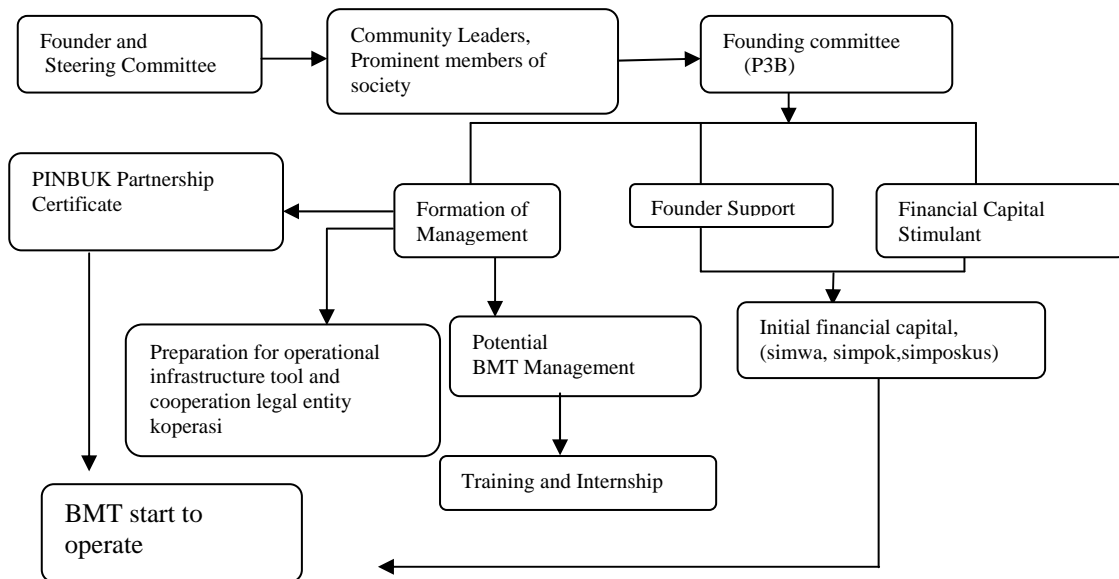
## DISCUSSION

### **BMT Business Model**

BMT is a Microfinance Institution that integrates all economic and social activities in the grass root level of society. The activity of BMT as *Baitul Tamwil* is to develop productive business by promoting saving activity and helping financing economic activities its members and the society in the area. BMT as *Baitul Maal* also has social function by supporting social funds such as *zakat*, *infaq*, *sodaqoh* (people’s charity fund) and distribute it with the principle of society empowerment accordance with the Islamic rules and regulations.

To establish a BMT is not a complicated process. A group of people who are interested to establish a BMT in their society need to find support from their community leaders and prominent members of their society. With the approval and support of the community leaders, this group can make founding committee (P3B) consist of 5 people. The main job of this committee is to get 20-40 people as First Founder who would like to invest in BMT (pay initial shares/ Simpoksus). For more details, the BMT establishment process is shown in flowchart Diagram 1.

BMT use shariah principle or profit sharing not interest based. The BMT's products include can be categorised into three: Purchase form, profit sharing form and borrowing form. For the purchase form, the major instruments in BMT, there are *Murabbahah* (cost plus margin), *Istisna* (purchase with specification), *Bai al Salam* (purchased with deferred delivery), *ijarah* (lease and hire purchase). Ninety to ninety five percent of BMT transaction is purchase form transaction, especially *Murabbaha* (Azis, 2004).



Source: PINBUK, 2005

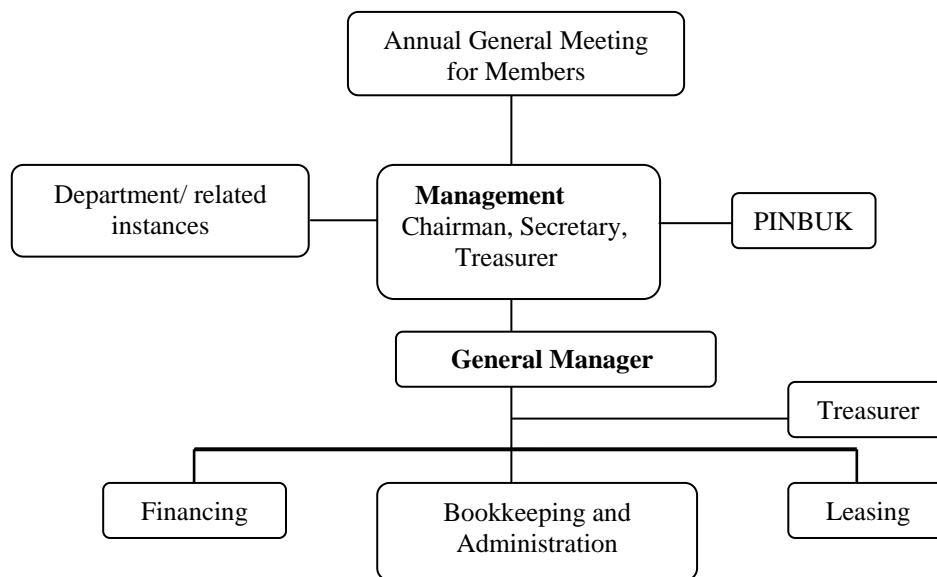
Diagram 1 BMT Establishment Process

## The Demand Source for BMT Accountability

The author identifies some parties who become the demand source for BMT accountability:

### BMT's Members

As cooperatives, BMT members should be the major party demanding the accountability from BMT's managers, just as shareholders demand accountability from the board of directors. BMT usually has organisational structure as shown in Diagram 2.



Source: Azis, 2004.

Diagram 2 BMT Organisational Structure

If BMT fully adopt cooperative institution model, BMT should only serve its member. However in the practice, as BMT operate as a bank, they have many customers and depositors. BMT Beringharjo in Yogyakarta with asset of IDR 12 billion and 3 branch offices, serves 11 000 members and depositor. The Director of BMT Beringharjo said to me, jokingly, if they have to make AGM and inviting all their depositors and members, they have to hold it in the soccer field.

As it is shown in the diagram above, it is clear that BMT managers are most accountable to Annual General Meeting (AGM). Because inviting all BMT members in the AGM is not applicable, usually BMT only invite their special members to the AGM. Their special members consist of their first founder, and members who have BMT share certificate. The AGM usually hold for 20-40 members. By having less people in the AGM, BMT can make decision faster. Another argument also that these 20-40 special members are the one who have more concerns on BMT performance and have power to direct managers. It is questionable as well whether a member borrow money \$10 from BMT or have a deposit for merely \$10 can get involve in the strategic decision making process.

## Monitoring Agencies

Supervisory Board should be one of the major financial statement users of BMT. Some BMT practitioners and analysts I interviewed express their concerns of the lack of supervisory body in the BMT industry. Different from *Shariah* Rural Banks (BPRS) who are supervised by Central Bank, BMTs as mostly cooperatives do not have any monitoring body.

Currently Ministry of Cooperatives and Small Medium Enterprise only give their status as legal entity but do not closely monitored the financial condition of BMT. This is where the monitoring organisation such as BMT Center, PINBUK and Microfin Indonesia plays an important role to set up the benchmark and monitor the development of their members.

However, most of the people in these monitoring organisations also find difficulties in collecting financial data of their members.

*“It is quite hard to ask for financial statements to our BMT members. We usually need to call them and ask them. They usually become more excited in submitting financial statements where it becomes one of requirements to get capital funding.”* Ida, BMT Center.

*“It is very hard for us to impose our BMT to submit their financial statement. We do not have any share or capital placement in the BMT, so the submission of the financial statement must be voluntarily. We also have communication difficulties to reach BMT in rural areas. We usually can get financial statements from BMT which are close to us or easily to reach by common communication tools.”* Budi Laksana, PINBUK.

*“For BMT who received funding grants from us, they usually need to submit their financial statement or progress report every month or in every three months. We usually do not have problem in asking the report as they know that it will determine their assessment. If they fail to do so, they might not be able to get the same grant next year. The downside of it is we can only force BMT who receive grants or in joining our channelling program.”* M. Sholeh, Microfin Indonesia

The absence of national supervisory board who supervise all BMT in Indonesia impose a great inherent risk for BMT. Although very rare, there are some cases where the treasurer or BMT's managers committed fraudulent actions by stealing BMTs' money and left the cash vault empty. Not all BMT are also healthy, some BMT have liquidity problem and facing going concern problem.

## **Ministry of Cooperatives and SME**

The Ministry of Cooperative and SME represent government that give legal status to BMT. Recently, in 2004, Ministry issue a new cooperative type; *shariah* financial service cooperatives (KJKS). The intention of this new cooperative type can be the legal form for BMT. However many BMT have already registered under *shariah* cooperatives type, especially those who are registered before 2004.

The new regulation for KJKS, UU No: 99/Kep/M.KUKM/IX/2004, article 35, stipulated that BMT who have asset more than IDR 1 billion has to be audited by independent auditor or audit service cooperatives. Those who are not obliged to be audited, need to have internal audit by internal auditor or special officer assigned by the cooperatives policy. The audited report need to be disclosed in Annual General Meeting and disclosed to public through announcement board or mass media. Those who are not comply with the regulation; the sanction will be reducing their credit rating.

Based on the explanation above, BMT should be accountable to the Ministry. However as the sanction is too light, this would not enough to provide incentive for BMT to be audited by independent auditor. It would be different for example if the sanction would be an operation suspension for BMT who do not comply with the regulation. This might will encourage more accountability of BMT.

## **Data Collection and Research Methodology**

Data about BMT is very difficult to find as there is no agency or department collecting the data from all BMT periodically. To gain knowledge about BMT's accountability, the author conducted a random survey to 101 BMT Directors/Managers. This survey was distributed at the first BMT National Conference in Jakarta, 2-5 December 2005. 101 BMTs surveyed came from 24 provinces in Indonesia (Table 1).

Table 1 BMT Respondents Profile by Provinces

No	Propvinces	amount
1	Aceh	2
2	Bali	2
3	Banten	3
4	Bengkulu	3
5	Gorontalo	2
6	West Irian Jaya	1
7	Jambi	1
8	West java	14
9	Centra Java	20
10	East Java	3
11	West Kalimantan	5
12	South Kalimantan	8
13	Lampung	4
14	Maluku	2
15	West Nusa Tenggara	5
16	East Nusa Tenggara	2
18	Riau	3
19	Sorong	1
20	South Sulawesi	1
21	West Sumatera	3
22	South Sumatera	5
23	North Sumatera	5
24	Yogyakarta	6
<b>Total Respondents</b>		<b>101</b>

As there are more than 3000 BMT in Indonesia, the author does not claim that the above sample is a right proportion to represent the whole BMT condition in Indonesia. A Survey with a set of questions was given out to the random respondents. Some directors/managers were also interviewed to know more about the details of their BMT's condition. The data then will be discussed in this paper using descriptive statistic.

## Findings and Discussion

In this section, the author will discuss three major findings regarding the accountability of BMT in Indonesia.

### BMT Print Their Financial Reports Regularly

Despite of the rumor that BMT are informal and lack of human resource with accounting knowledge, 97% of BMT claimed that they produce balance sheet and income



statement. 3 respondents who admitted that they never make financial statements is because they are just newly established (less than a year). 93% percent use cash basis accounting while the other 7% use accrual accounting. From some of interview, there are some BMT admitted that they use cash accounting for revenue but apply accrual accounting for expenses.

When respondents are asked “how often do you print your financial report?” Most BMT claimed they print and analyze their income statement and balance sheet on monthly basis (53%), even 14% of respondents that they print their financial report every day. They enable to do that as they have integrated accounting software installed in their operation, thus to derive financial reports from the system on daily basis is not difficult.

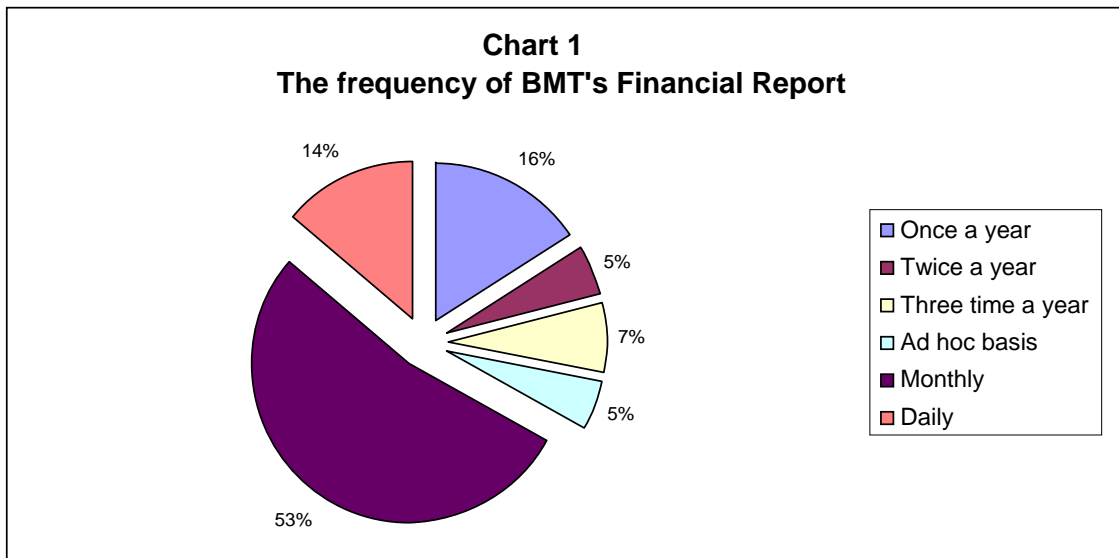


Chart 1 The frequency of BMT's Financial Report

### **Most of BMT Are Not Audited by Independent Auditor**

Financial audit by independent and professional audit can provide a high level of assurance through enhances the credibility of accountability matter. Auditors also have limited obligation to detect fraud and other illegal acts (Gill, et al, 2001). However, from 101 respondents, only 14 BMT admitted that they ask independent auditor to audit their operation and financial report.

Interestingly, some BMT who are audited are not BMT who are required to be audited by independent auditor. Based on the regulation from Ministry of SME and cooperatives, only BMT with asset more than IDR 1 billion required to be audited by independent auditor (Article 35 of UU NO.91/Kep/M.KUKM/IX/2004). From those 14, only 9 BMT have asset more than IDR 1 billion, thus required by the law, the other 5 BMT actually are not required.

There are 23 BMTs in my respondent with asset more than IDR 1 billion, however only 9 of them claimed that they were audited by independent auditor. Nevertheless, important to be noted that almost all BMT claimed they are audited, for some extent by their development agencies (Pinbuk, Dompot Dhuafa or Local representative of Ministry of SME and cooperatives). However, knowing the fact that PINBUK and Dompot Dhuafa, their main business is not auditor; the level of audit that they perform is somewhat questionable. Especially after I ask to officer in PINBUK central office, they admitted that they do not have manpower to conduct a proper audit to their 3000 members.

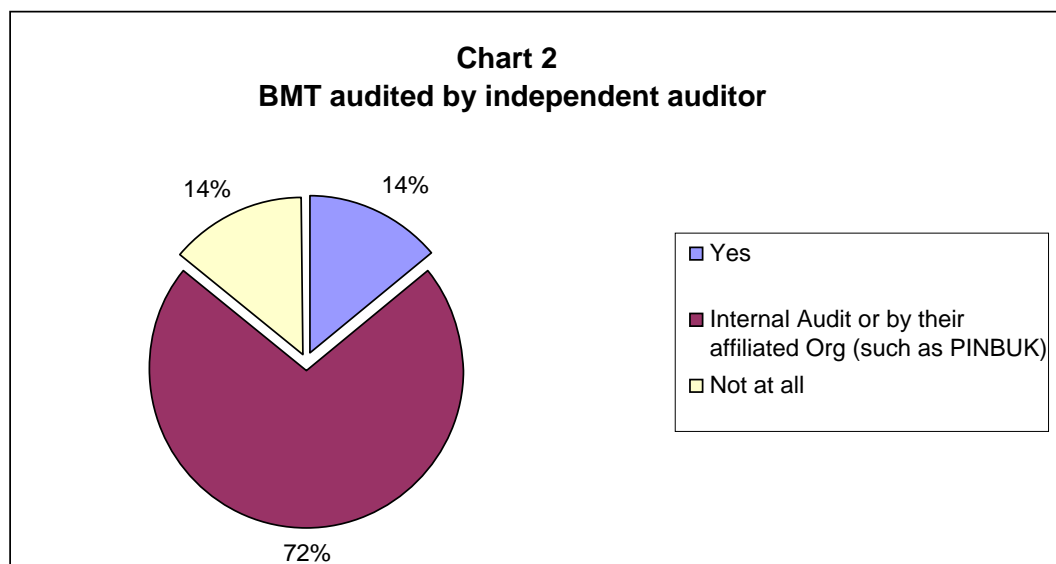


Chart 2 BMT Audited by Independent Auditor

### The Reasons for Independent Audit Avoidance

As discussed before, only 14 out of 101 BMT respondents have their financial statements audited by independent auditor. The main reason for audit avoidance is because BMT managers feel that they do not need audited financial statements. 53%

claimed that they do not need to be audited mostly because their members or AGM do not require audited financial statements. 41% claimed that the cost for audit is relatively expensive and only 4% answered they do not see the benefit of being audited.

Many BMT managers I interviewed give their reason they do not need an audit by independent auditor because they see their asset is still relatively small. The Director of BMT Beringharjo with asset about IDR 12 billion admitted that the main reason that her BMT has not being audited because it is relative expensive. She admitted that the auditor asked for IDR 12 million for audit fee, or 1% from the total asset. She said better the money being used to help the poor than giving it away to the independent auditors.

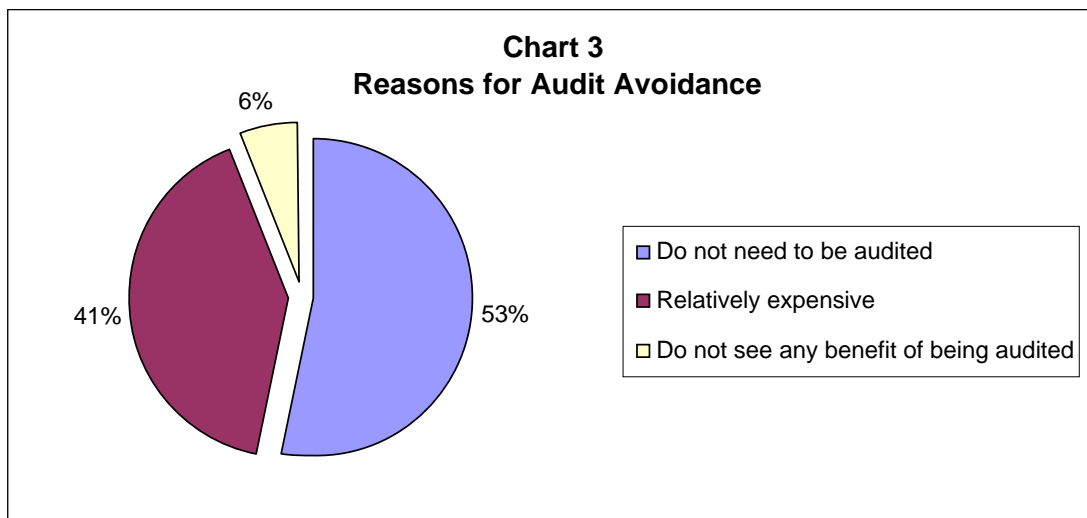


Chart 3 Reasons for Audit Avoidance

Some managers admitted that they feel they do not need an independent proper audit because they see many other BMT have not being audited either. If many BMT with asset more that IDR 1 billion can get away without being audited, why would smaller BMT have to spend money to pay an independent auditor? They closely benchmark them selves with big BMTs, thus if big BMT start to hire independent auditor it would attract other BMT to do the same.

## CONCLUSION

The development of Islamic Saving and Loan Cooperatives or BMT in Indonesia has been exceptional. However, the rapid development of BMT, is not followed by the development of reporting regulation and accounting standards. Currently there is no accounting standard specially made for BMT.

However despite of the absence of accounting standard for BMT, from the survey, it is revealed that more than 50% BMT print their balance sheet and income statement in monthly basis. 14% even claimed that they print their financial statements on the daily basis.

BMT actually have 3 parties who can become their demand source for accountability; BMTs members, monitoring agencies such as PINBUK and The Ministry of cooperatives and SME. However, due to the low enforcement from these parties, BMT managers are not encouraged to have their financial statements audited by independent auditors. They need more incentives to pay independent auditor to run financial audit.

The numbers of BMT who are audited by independent auditor is very low. Only 14 BMT from 101 respondents are audited by independent auditor, while 72% claimed that have internal audit process or being audited by their monitoring agency or Ministry of cooperatives and SME, and the other 14% admitted that they do not run any audit process at all.

The main reason for independent audit avoidance is the absence of audit necessity. 53% BMT managers feel that they do not need an independent audit, mostly because their members do not require them to do it. The other 41% feel that the cost for an audit would relatively be expensive.

Lack of supervisory and regulations create prudential dangers to BMT depositors and members. As the role of BMT in developing microfinance industry is increasing rapidly, Indonesian Government need to make more guidance, regulation and national supervisory agency for BMT. Government also need to create more incentive for BMT managers to improve their accountability to their members and society.

Another research need to be conducted to gather information on what challenges BMT managers have in the accounting process or in producing accountable financial reports. The information will be helpful for monitoring agency to improve the BMT's accountability. Also a firm sanction should be imposed by the Government or monitoring agency for those big BMT that avoid independent financial audit.

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